

Before the  
Federal Communications Commission  
Washington, D.C. 20554

In the Matter of )  
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Protecting and Promoting the Open Internet ) GN Docket No. 14-28  
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On May 15, the Commission released a Notice of Proposed Rulemaking in the above-referenced proceeding.<sup>1</sup> Among other things, the *NPRM* seeks comment on whether the Commission should rely on its authority under Title II of the Communications Act and revisit its classification of some or all broadband Internet access services as an “information service” for the purpose of subjecting them to more regulation.<sup>2</sup>

I. THE CURRENT CLASSIFICATION OF BROADBAND AS AN INFORMATION SERVICE IS THE CORRECT ONE

As the *NPRM* notes, the Commission classified broadband Internet access services as information services that are not subject to Title II (which governs “telecommunications”) and cannot be regulated as a common carrier service beginning in 2002.<sup>3</sup> As the Commission is well aware, the telecommunications and information service definitions were developed by Judge Harold H. Greene in the Modification of

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<sup>1</sup> *Protecting and Promoting the Open Internet*, GN Docket No. 14-28, Notice of Proposed Rulemaking (rel. May 15, 2014) (*NPRM*).

<sup>2</sup> *NPRM*, Sec. III. F. 2.

<sup>3</sup> *NPRM*, para. 148

Final Judgment (MFJ) that divested the Bell Operating Companies from AT&T in the early 1980s, and they reflect decades of prior Commission rulemaking. Congress codified the definitions in 1996 with overwhelming bipartisan support.

In 1997, Congress directed the Commission to consider the application of the definitions in some detail. After having sought and reviewed thousands of pages of public comments, the Commission issued a Report to Congress the following year.<sup>4</sup> In the Report, the Commission observed, among other things, that

Senators Ashcroft, Ford, John F. Kerry, Abraham and Wyden emphasize that “[n]othing in the 1996 Act or its legislative history suggests that Congress intended to alter the current classification of Internet and other information services or to expand traditional telephone regulation to new and advanced services.” Like Senator McCain, they state: “Rather than expand regulation to new service providers, a critical goal of the 1996 Act was to diminish regulatory burdens as competition grew.” (footnotes omitted.)<sup>5</sup>

And the Commission concluded,

...when an entity offers transmission incorporating the “capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information,” it does not offer telecommunications. Rather, it offers an “information service” even though it uses telecommunications to do so. We believe that this reading of the statute is most consistent with the 1996 Act’s text, its legislative history, and its procompetitive, deregulatory goals.<sup>6</sup>

As this analysis by the Commission suggests—and as the statute makes clear—the classification of broadband Internet access services is a definitional issue, not a policy choice for the Commission. The Commission has correctly classified broadband as an information service not subject to Title II regulation, and the Supreme Court affirmed (with respect to broadband service provided by cable operators) in 2005. Overturning a

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<sup>4</sup> *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report to Congress, 13 FCC Rcd 11501 (1998), para. 12.

<sup>5</sup> *Id.*, para. 38.

<sup>6</sup> *Id.*, para. 39.

central feature of the Telecommunications Act of 1996 is a matter for Congress to undertake in its discretion, not the Commission.

When the Supreme Court upheld the Commission's classification of cable broadband as an information service in 2002, the Court agreed with the Commission that a consumer does not use "pure transmission" when he or she accesses content provided by parties other than the cable company.<sup>7</sup> The Court agreed that DNS and caching are two examples of how processing and storage are combined with transmission to furnish a finished broadband service. This is not an exhaustive list, as Professor Yoo points out.

Broadband Internet access providers also typically include spam filtering, virus protection, and a wide range of other services that far exceed the transparent transmission associated with telecommunications services.<sup>8</sup>

The *NPRM* asks whether there have been significant changes to the broadband marketplace that should lead the Commission to reconsider its prior classification decisions.<sup>9</sup> Viewed from the perspective of the statutory definitions—the only perspective that counts—the answer is no. Broadband providers are combining transmission with other functions, including but not limited to processing and storage, in ever more ways.

## II. RECLASSIFICATION WOULD NOT NECESSARILY PROHIBIT PAY-FOR-PRIORITY

The *NPRM* also asks how a Title II reclassification approach would serve the Commission's goal to protect and promote Internet openness.<sup>10</sup> If "Internet openness"

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<sup>7</sup> *National Cable & Telecommunications Ass'n v. Brand X Internet Services*, 545 U.S. 967 (2005).

<sup>8</sup> Christopher S. Yoo, *Is There a Role for Common Carriage in an Internet-Based World?* (2013). *Houston Law Review*, Vol. 51, p. 545, 2013; U of Penn, Inst for Law & Econ Research Paper No. 13-37. Available at SSRN: <http://ssrn.com/abstract=2370068>.

<sup>9</sup> *NPRM*, para. 150.

<sup>10</sup> *NPRM*, para. 149.

is defined as the absence of any pay-for-priority arrangements, the answer is it may not. Section 202 of Title II of the Communications Act prohibits “unjust or unreasonable discrimination” and “undue or unreasonable preference or advantage.”<sup>11</sup> As scholars have noted, “price discrimination remains the norm rather than the exception across the telephone industry.”<sup>12</sup> AT&T points out that telephone companies subject to Title II regulation are free to negotiate contracts that include preferential treatment such as quality-of-service guarantees as well as expedited and prioritized service installation and repair.<sup>13</sup> The Commission has also allowed telecommunications providers subject to Title II regulation to make numerous price distinctions—including volume discounts, term discounts, multiple service discounts and competitive-necessity discounts.<sup>14</sup>

In the past, businesses and long-distance customers were charged inflated prices for the purpose of cross-subsidizing flat-rate local telephone service for consumers.

To maintain good relations with state regulators, operating company managers set local rates in accordance with what telecommunications lawyers would wryly call the “pizza test”: under no circumstances was the monthly fee for basic residential service to exceed the price of a pizza-medium size-with two toppings.<sup>15</sup>

The discriminatory pricing didn’t occur because Title II wasn’t there to prevent it—the price discrimination was in response to the political imperative of providing artificially low-priced basic residential service that common carrier regulation in effect mandated. The pervasive system of cross-subsidization had the effect of inhibiting innovation, because telephone companies weren’t allowed to profit from innovative

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<sup>11</sup> 47 U.S.C. §202.

<sup>12</sup> Peter W. Huber, Michael K. Kellogg and John Thorne, *Federal Telecommunications Law* (2d. ed.), Aspen Law & Business (1999), 289.

<sup>13</sup> Letter from Robert W. Quinn, Jr., Senior Vice President-Federal Regulatory and Chief Privacy Officer, AT&T Services, Inc., to Marlene H. Dortch, Secretary, Federal Communications Commission, GN Docket No. 14-28, at 6 (filed May 9, 2014).

<sup>14</sup> *Id.*, 6-7.

<sup>15</sup> Richard R. John, *Network Nation: Inventing American Telecommunications* (Belknap Press, 2010), 409.

service offerings—instead, regulators would siphon those profits to pay for even lower monthly bills for basic residential service. Regulation also created an unnatural incentive for telephone companies to resist competition in the areas of the business that were needed for subsidizing basic residential service, both because prices in those areas were well above cost and because competitors had no obligation to contribute to the preservation of universal service.

### III. TITLE II RECLASSIFICATION WOULD JEOPARDIZE INVESTMENT AND INNOVATION

The *NPRM* gives short shrift to the need for continuing investment and innovation not only at the edge of the network, but also within the network. Indeed, the *NPRM*'s observation that both “within the network and at its edges, investment and innovation have flourished while the open Internet rules were in force” provides no basis for a finding that Title II will not jeopardize investment and innovation within the network. The regulations that were in the 2010 *Open Internet Order* were relatively narrow and targeted compared to Title II. Indeed, as the Commission noted,

... the high-level rules we adopt carefully balance preserving the open Internet against avoiding unduly burdensome regulation ... rules that reinforce the openness that has supported the growth of the Internet, and do not substantially change this highly successful status quo, should not entail significant compliance costs.<sup>16</sup>

Common carrier status for broadband, on the other hand, is a potential Pandora's Box. Even if the Commission intends to—and ultimately does—forebear from enforcing various sections of Title II, that process could involve contentious rulemakings and successive litigation. Speaking on the need to resist oppressive regulation of broadband in 1999, former Chairman William E. Kennard warned,

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<sup>16</sup> *Preserving the Open Internet*, GN Docket No. 09-191, WC Docket No. 07-52, Report and Order, 25 FCC Rcd 17905, 17928, para. 39 (2010) (*Open Internet Order*).

... I come to this debate as a battle-scarred veteran of the telephone wars. I have been in those battles. I helped write the regulations implementing the 1996 Telecom Act. I was general counsel when that process was on-going. I defended those rules all the way up to the United States Supreme Court. I am still defending them. I believe in them. But I also know that it is more than a notion to say that you are going to write regulations to open the cable pipe. It is easy to say that government should write a regulation, to say that as a broad statement of principle that a cable operator shall not discriminate against unaffiliated Internet service providers on the cable platform. It is quite another thing to write that rule, to make it real and then to enforce it. You have to define what discrimination means. You have to define the terms and conditions of access. You have issues of pricing that inevitably get drawn into these issues of nondiscrimination. You have to coalesce around a pricing model that makes sense so that you can ensure nondiscrimination. And then once you write all these rules, you have to have a means to enforce them in a meaningful way. I have been there. I have been there on the telephone side and it is more than a notion. So, if we have the hope of facilitating a market-based solution here, we should do it, because the alternative is to go to the telephone world, a world that we are trying to deregulate and just pick up this whole morass of regulation and dump it wholesale on the cable pipe. That is not good for America.<sup>17</sup>

The top priority for the Commission in this proceeding should be to “not substantially change [the] highly successful status quo.” Otherwise, the Commission must carefully evaluate how much the “virtuous circle of innovation”<sup>18</sup> is threatened on both ends—not only from the hypothetical “short-term incentives [of broadband providers] to limit openness, generating harms to edge providers and users, among others”; but also from the long-term disincentives that an ever-present threat of stifling regulation could create for private investors who might otherwise be willing to contribute the capital needed to build faster and more ubiquitous broadband infrastructure. Edge providers have as much to lose from the second possibility as from the first.

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<sup>17</sup> Remarks by William E. Kennard, Chairman, Federal Communications Commission, at the 19<sup>th</sup> Annual Conference of the National Association of Telecommunications Officers and Advisors, Atlanta, GA (Sept. 17, 1999).

<sup>18</sup> *Open Internet Order*, para. 14 (“new uses of the network—including new content, applications, services, and devices—lead to increased end-user demand for broadband, which drives network improvements, which in turn lead to further innovative network uses.”).

Private investors seek the highest reward for their investment adjusted for risk, and broadband is but one of many investment opportunities. Title II regulation opens the door to the possibility that regulators could (at any time) intervene to confiscate the fruits of successful investment (for a purpose such as reducing the prices that broadband providers' wholesale or retail customers are obliged to pay). Indeed, the more profitable an investment might be, the higher the likelihood that regulators will intervene to reallocate the profits. A risk-averse private investor considering these odds would have a strong incentive to consider the alternative of government savings bonds. There they can earn the same "acceptable" return with far less (zero) risk. An investor who is willing to roll the dice might not consider broadband at all, because there is at best an average return on investment and at worst a complete loss. In the old days of the government-sanctioned Bell System monopoly, there was a guarantee of an average return on investment combined with a zero risk of loss. Those days are long gone. Private investment in advanced networks is not a "given," and Title II regulation of broadband services won't produce the same investment results (attracting plenty of investment at no more than an average rate of return) as did Title II regulation of the Bell System.

#### IV. BROADBAND PROVIDERS SHOULD BE PERMITTED TO EXPERIMENT WITH INNOVATIVE PRICING MODELS

The 2010 *Open Internet Order* acknowledged the possibility that broadband providers could "avoid increasing or could reduce" the prices they charge consumers if they are allowed to "earn substantial additional revenue by assessing access or prioritization charges on edge providers ..."<sup>19</sup> Commissioner Pai sees "no legal path for

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<sup>19</sup> *Open Internet Order*, para. 28.

the FCC to prohibit paid prioritization or the development of a two-sided market—which appears to be the *sine qua non* objection by many to the Chairman’s proposal.”<sup>20</sup>

The Commission listed two objections to the two-sided market scenario in the *Open Internet Order*: (1) “no broadband provider has stated in this proceeding that it actually would use any revenue from edge provider charges to offset subscriber charges,” and (2) “likely detrimental effects of access and prioritization charges on the virtuous circle of innovation.”<sup>21</sup>

#### A. Broadband Providers Likely Would Have An Incentive to Offset Subscriber Charges Using Revenue from Edge Providers

Broadband providers would have an incentive to use revenue from edge providers to offset subscriber charges depending either on whether they perceive they might gain a competitive advantage or whether consumers can be expected to purchase more of the service at a lower price. Andrew Odlyzko has found that,

There are repeating patterns in the histories of communication technologies, including ordinary mail, the telegraph, the telephone, and the Internet. In particular, the typical story for each service is that quality rises, prices decrease, and usage increases to produce increased total revenues.<sup>22</sup>

Odlyzko’s insight suggests that the profit-maximizing behavior for broadband providers is to accommodate as much Internet traffic as possible. Obviously, to do that, broadband providers cannot risk making the Internet less attractive for end users by limiting content and innovative offerings.

When telecommunications providers have asked regulators in the past to reduce long-distance access fees, their proposals have met with the same skepticism, *i.e.*, in the

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<sup>20</sup> Dissenting Statement of Commissioner Ajit Pai, GN Docket No. 14-28 (May 15, 2014).

<sup>21</sup> *Open Internet Order*, para. 28.

<sup>22</sup> Odlyzko, Andrew, *Internet Pricing and the History of Communications* (February 26, 2012). *Computer Networks*, Vol. 36, pp. 493-517, 2001. Available at SSRN: <http://ssrn.com/abstract=235283> or <http://dx.doi.org/10.2139/ssrn.235283>.

absence of a commitment or a mandate, what guarantee is there that the carriers will share their gain with their customers? Scholars have observed that as states have reduced in-state long-distance access fees, “the market induces carriers to pass-through most of the reduction in access rates.”<sup>23</sup> There appears to be no reason to believe that a similar dynamic wouldn’t occur in the context of a two-sided broadband market.

#### B. Access and Prioritization Charges Could Increase the Value of Content, Applications, Services and Devices

Broadband providers benefit from the virtuous circle of innovation. The *Open Internet Order* acknowledges this point: “Each round of innovation increases the value of the Internet *for broadband providers* (emphasis added), edge providers, online businesses, and consumers.”<sup>24</sup> Broadband providers have an incentive to expand their networks, not to charge inefficiently high prices that would have the effect of reducing the demand for their services. There is no basis for a blanket presumption that judicious access and prioritization charges would break the circle of innovation. On the contrary, there is a possibility that reduced subscriber charges could increase the number of broadband subscribers and create a larger market for edge providers. The *Open Internet Order* acknowledges the possibility that reduced subscriber charges could outweigh any risk of harm to the virtuous circle of innovation.<sup>25</sup> The Commission should not foreclose innovative pricing models that could expand the network and increase the value of content, applications, services and devices.

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<sup>23</sup> Aron, Debra J. and Burnstein, David E. and Danies, Ana C. and Keith, Gerry, An Empirical Analysis of Regulator Mandates on the Pass Through of Switched Access Fees for In-State Long-Distance Telecommunications in the U.S. (June 19, 2013). Available at SSRN: <http://ssrn.com/abstract=1674082> or <http://dx.doi.org/10.2139/ssrn.1674082>.

<sup>24</sup> *Open Internet Order*, para. 14.

<sup>25</sup> *Id.*, para. 28.

## CONCLUSION

For these reasons, the Commission should reject any invitation to rely on its authority under Title II of the Communications Act and revisit its classification of some or all broadband Internet access services as an information service for the purpose of subjecting them to more regulation.

Respectfully Submitted,

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*The views expressed herein are those of the author and do not necessarily reflect those of the Discovery Institute.*